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Economic Perspective 1

ROYAL DOCKYARDS: TIME FOR ACTION

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THE STATE OF THE DEBATE

That there is a case for changes in the way the Royal Dockyards are managed, and the way the employed workforce goes about the taxpayers' business, is probably the only thing all parties to the current discussions on commercial contract management agree about. Indeed, the trade unions, while giving evidence to the House of Commons Defence Committee in June, on more than one occasion assured MPs that they did not think that the status quo could continue, though they were unspecific as to what changes, if any, they saw as likely to be forthcoming from their side.

Much of the criticism of the Secretary of State for Defence, Mr Heseltine, has concentrated on the procedural rather than the substantive issues associated with the latest flurry of reports on the future of the dockyards. By concentrating on the not unimportant issue of the lack of time for consultation (nominally 12 weeks, but much less in fact), the trade union and local authority witnesses (some of them overlapping in status) convinced the House of Commons Defence Committee to issue a unanimous criticism of the Minister's (mis)handling of his proposals for quite radical, and unprecedented, dockyard reform (House of Commons Paper, No 453, 1985). The Public Accounts Committee (House of Commons Paper No 44, 1985) also expressed scepticism at the financial savings the Ministry expected from its contractorisation plans.

Old hands among observers of the parliamentary process will recognise the well-worn technique of opposing something indirectly by first attacking its timing rather than its content, and, if that does not give the Minister, or failing that his

nervous colleagues, cold feet, then going on to attack hair-raising, but nonetheless hypothetical, consequences of the content itself. In Whitehall, 'death by a thousand exceptions', has seen off more than one reforming proposal. A close reading of the union evidence ('Giving the Royal Dockyards a Chance', December 1984), their submissions to the Defence Committee (House of Commons paper No 453), and media comment by the local MPs, suggests that a typical 'snow job' is underway.

Mr Heseltine must defend himself for his management of his reform proposals. However, most of the resentment at the way the issue has been handled is a diversion from the main question: what can be done about the Royal Dockyards in a short enough time scale to make a difference to their manifest problems, all of which have been known since the Mallabar committee reported in 1971 (Cmd 4713).

Those who have joined this debate only recently may be surprised to know just how many times the dockyards have been examined and found wanting, and, as pertinently, have been found wanting for precisely the same reasons as were pointed out by Sir John Mallabar in 1971. It is, therefore, somewhat disingenuous for the opponents of actual, as opposed to abstract, change in the dockyards to require more time for discussion when discussion has been underway for fifteen years. While not endorsing Mr Heseltine's style of management, I understand his fears that another prolonged bout of internal consultation and nit-picking negotiations would do to his April 1985 proposals (Defence Open Government Document 85/01: The Future of the Royal Dockyards: a consultative document for employees) what the unions and civil service did to the Mallabar proposals of 1971 and the Speed proposals of 1980 ('The Royal Dockyards: A

Framework for the Future', 2 Vols).

The plain fact is that the unions prefer to leave the dockyards more or less as they are, and such change as they are grudgingly prepared to accept now, (the Trading Fund proposals for example), is a tactical stance to prevent changes which challenge their relatively soft conditions of service, less than onerous working practices and their civil service index-linked pension entitlements. Self interest, as Adam Smith explained, is one of the most powerful motivators of behaviour, but collective self interest is even more powerful and experience suggests that it is also normally against the public interest, leaving the onus on those who espouse it to demonstrate that their version is a social benefit.

REFORM PROPOSALS SINCE 1971

The Mallabar committee was set up in 1968 to report on the Royal Dockyards and other Government owned industrial enterprises. It found that there were 'symptoms of an unhealthy situation' in the operation of the yards, such as high levels of overtime working, combined with high levels of 'waiting time' (tradesmen standing about waiting for another trade to undertake work before they could themselves continue), and generally low productivity. In other words, the typical situation prevailing in much of UK industry which prompted the kind of revisions of working practices demonstrated in the Fawley productivity agreements and many others.

Mallabar thought that certain unique features of the naval dockyards added to their problems. For example, there was no clear distinction between the Royal Dockyards as a managerial entity and the sole customer for whom they worked, ie the Royal Navy. This precluded the development of self-confident managers in the yards. In addition, the confusion (to put it mildly) of the internal costing systems, designed more for parliamentary procedures (the annual 'Votes') than for managerial decision making and performance evaluation, inhibited the development of modern managerial skills. If nobody knows exactly what it costs to do anything nobody can be sure that changes improve efficiency. All wages and conditions, manning levels and recruitment are decided not by the

managers of the yards on the basis of decisions for which they would be accountable nor in consultation with the local trade unions, but by a centralised bargaining process (the Whitley councils) between the civil service and unions that set national standards irrespective of local circumstances. Add in the bouts of incomes policy during 1964-1978 and the consequences were predictable. This undermined local managerial authority.

Mallabar examined the possibilities for reform and set out the problems of implementation. As all of these options are still on the table it makes sense to note Mallabar's conclusions. A reversion to full naval control was rejected on the grounds that the Royal Navy did not have the appropriate managerial skills and that such a move did nothing for the desired separation of the dockyards from the sole customer. Transfer of work into private shipyards was excluded on the grounds that there were 'insufficient facilities' available for such a transfer. Nor was it feasible, in Mallabar's view, for private capital to take over the yards (a 'friend in the City' informed him there was no interest in such a venture!). Interestingly, in view of the current Heseltine proposals, the idea of agency management was rejected on the grounds of the unsatisfactory experience of such arrangements during the 1939-45 war, often quoted by trade union critics of the Minister. Setting up a public corporation to manage the yards (nationalisation) was rejected on the grounds that it would not be competitive enough to ensure 'value for money'.

Mallabar's preferred option was a Trading Fund and he recommended a target date of 1974 for its establishment. This idea had the backing of the Fulton Report (Cmd 3638, 1968) and gained parliamentary approval in the Government Trading Funds Act of 1973. Trading Funds were fashionable and they were recommended for the Royal Mint, the Royal Ordnance Factories, the Royal Dockyards, HMSO, and the Property Services Agency. It would not be unfair to report that the trade unions were (and remain) suspicious of proposals to hive-off civil service activities into Trading Funds. They are seen as precursors of privatisation (eg the Royal Ordnance).

Under a Trading Fund the dockyards would be required to earn a revenue 'taking one year with another', sufficient to cover their outgoings, including a capital charge for assets and facilities. The

staff would be outside the civil service establishment and, thus, immune to politically inspired 'number cutting', but the dockyards would also be independent entities and hence vulnerable to 'privatisation'. In the light of these features, current trade union willingness to accept Trading Fund status for the dockyards is ambivalent and largely tactical.

However, Mallabar's proposals for Trading Fund status did not come to fruition. In fact, the date for establishing such a fund slipped back, first from April 1974 to April 1976 and then to April 1978, as the civil service found 'difficulties' in setting one up. The new Conservative Government in 1979 set up another enquiry, under the navy minister, Keith Speed, to examine the 'crisis in the dockyards'. He reported favourably on the Trading Fund solution and followed Mallabar in rejecting alternatives, including commercial management.

Meanwhile, the former Defence and External Affairs Committee of the House of Commons (24 July 1973, October 1975, December 1976), its successor the Defence Committee (2nd Report, Session 1980-81), and from time to time the Public Accounts Committee (22nd Report, Session 1983-84, June 1984) pursued the subject of what had happened to the proposals for reform and found a continuing failure to tackle anything substantial. A number of minor changes that were introduced ended in failure: the incentive scheme on a trial basis at Chatham dockyard in 1976, and the Dockyard Efficiency Scheme in 1981, which from current reports has also failed to raise productivity. In this respect, a comment by the Defence Committee that incentive schemes in the dockyards were 'corrupted by the negotiating process' will not surprise anybody familiar with industrial relations in highly protected establishments.

THE PROBLEMS

The Royal Dockyards exist to service ships and submarines of the Royal Navy and to ensure that the fleet is available operationally to meet the navy's assignments. Modern naval ships and submarines are formidably complex in their structures and in the warfighting equipment they carry. About 60% of a modern ship's cost is accounted for by its sophisticated electronics and warfighting capacity. A refit of a Polaris class nuclear submarine costs around £300 million and a modern frigate refit can

cost upwards of £50 million.

The two dockyards, Rosyth and Devonport, had estimated production costs of £537 million in 1983-84 (Statement on the Defence Estimates, 1985, Cmnd 9430-II). Rosyth, the smaller of the two yards, employs 8,500 people, providing a quarter of all employment in the Dunfermline area. Devonport employs 13,100 people out of 32,000 employed in manufacturing in Plymouth. The managerial challenges that these organisations face can be gauged by noting that there are only about 100 individual establishments in the UK employing on site more people than the Rosyth dockyard.

The relationship between the Royal Navy and the Royal Dockyards is regarded by dockyard management (and acknowledged by the Royal Navy) as being detrimental to efficiency. This is partly the result of the difficulty in predicting the extent of the work that will be required during a refit until the equipment on the ship is stripped out. This does not matter too much in an operational sense, but with budgetary restraint, and in circumstances where the Admiralty wishes to move resources from support to the front line, the unforeseen element of refitting cannot remain immune to controls.

Some critics of commercial management believe that the unforeseen element in a refit precludes fixed cost contracting and would lead to a cost-plus pricing, a notorious means to extravagance. The Chief Executive, Royal Dockyards, Admiral A S George, believes that the unforeseen element, with proper and commercial management techniques, can be reduced from about 30% towards 10%, and the 10% can be handled by individual fixed price contracts negotiated between a new Navy Board contract negotiating function (which is being set up anyway) and commercial managers (Evidence to the Defence Committee, July 1985).

Another problem arising from the 'cosy' relationship between the Navy and the dockyards is that of emergency work demanded from the dockyards, on the instructions of the Royal Navy, without penalty for the costs of disruption. This can account for 10% of the dockyard's workload. Commercial management would force the navy to confront the costs of this work and make choices about the

alternative use of naval resources. This too is welcomed by the dockyard managers (Ibid).

Overtime working is inevitable in a maintenance function but whether it needs to be paid for (thus producing an incentive to create it) is another matter. Commercial companies elsewhere in the UK have eliminated paid overtime, and its attendant abuse, by time off in lieu schemes based on a guaranteed annual salary. That the dockyards, as late as 1984 were still trying to contain overtime (about 14% of all hours worked) by executive exhortation is itself a comment on the need for change.

As long ago as the Fawley productivity agreements of 1970, symptoms of a workforce demoralised by lack of application and artificial restrictive practices were well documented. The fact that the dockyards' industrial employees have an absenteeism rate 40% above the national average (19 days off a year compared to 13 elsewhere) signifies the effects of high overtime and high waiting time on the commitment of the employees. The latter is the result of restrictive practices, many of which have already been foregone in those businesses where losses lead inevitably to redundancies.

The scope for productivity improvements was noted in the Peat Marwick study commissioned by Plymouth City Council (Defence Committee, HC Paper 453). Labour performance at Devonport, measured on British Standards Institute principles, allowing for 'normal relaxation, clean-up, walking time, waiting time and other contingencies', should produce work at 100 performance on the BSI scale. Actual performance is about 75 (implying a not too onerous effort) and therefore an improvement of over 20% in productivity in the dockyard is attainable. Within the current regime, however, it is not being achieved. In the Falklands emergency the dockyards did as much welding in a week as they normally do in four months.

THE COMMERCIAL MANAGEMENT OPTION

The Minister of Defence, Mr Heseltine, has initiated a number of changes within the Ministry to sharpen up its performance and to shift resources within the defence budget towards more effective 'front line' capability. These changes have been

underway since he assumed office not longer after the Falklands emergency. They involve managerial changes at the top of the Ministry, increased accountability for the use of resources at all levels (the MINIS system) and a shift of emphasis away from in-house operations to various forms of exposure to competitive pressures.

It is not surprising that he turned his attention to the Royal Dockyards. Nor is it surprising that having read through all the previous reports he decided that action was a more effective antidote to their manifest problems than yet more enquiries. His then personal advisor, Mr Levine, undertook a swift survey of the options facing the dockyards and reported that the commercial management option was the one most likely to achieve the sought for results. The Levine memorandum (9 February 1984) was 'leaked' to the unions not long after it was on restricted circulation in the Ministry and, while it remains unpublished, extracts have appeared in various places.

The commercial agency proposals were the Minister's preferred option. In fact, the Minister has announced he intends to proceed with this option with a vesting day of 1 April 1987. Briefly, the Government would continue to own the physical assets of the dockyards and to be responsible for capital investment in them. There would also be provision for emergency requisition of the yards under direct Ministry control if circumstances arose necessitating such a measure. These steps meet, in the Minister's view, all the reserve powers needed in respect of national security.

Several commercial companies are currently in discussion with the Ministry with a view to the submission of a detailed prospectus and, as is usual in contracts of this size, with proof of capability and financial soundness for taking over the commercial management of the dockyards, including the workforce and the work in progress. Employing Companies will be established, separate from the Ministry and the contractors, as 'labour only' companies, and all employees of the two dockyards would be permanently established with one of the companies (one for each yard). Their current conditions of work would be protected within each company. The contractor would use the manpower resources of the existing Employing

Company and be responsible for it being adequately funded for wages and such like (recovering the costs from the prices quoted to the Ministry for refitting work). The Minister would have residual powers to influence the Employing Companies, but would generally have an 'arms length' relationship with them.

The rather complicated relationship envisaged arises largely from the many considerations involved in this unique experiment in commercial management of the dockyards, which must, for practical reasons of industrial relations, continuity of employment, national security and public concern, take account of far more factors than would be normal in a straight privatisation option (see Briefing Paper, No 12. The Concept of Employing Companies, MOD in HC 453).

The successful contractors (one for each yard) would be assured of about 70% of the core work of the Royal Navy, and would compete for additional work with private yards. This introduces a competitive edge into the dockyards and requires improved performance if they wish to work up to their capacities.

Separate from this exercise, though not entirely uninfluenced by it, there is to be a rundown of establishment at Devonport of 2,000 jobs and at Rosyth of about 400 before 1987. From 1987 the yards are required to modernise their working methods and reduce their operating costs to make them competitive with outside contractors in private yards. The Minister, in the longer run, can vary the amount of core work guaranteed to the contractors, thus putting pressure on the commercial managers if their performance is not satisfactory. He also has the sanction of not renewing the contract at the end of each five years, and, in ultimate emergency, of taking the yard over if circumstances, such as commercial default, warrant it.

From the Royal Navy's point of view the change to commercial management in the dockyards and competitive tendering for 20% of the refit work is worthwhile if it reduces refitting costs and releases funds for alternative uses within the defence budget. This, however, cannot be guaranteed in advance under any managerial regime. To date the Public Accounts Committee is unconvinced that costs will be reduced more than marginally. The

Navy Board thinks they will be reduced at most by up to £30 million a year (less than 6% of total costs); the PCA, not unused to halving 'loaded' forecasts by Government departments, thinks it more likely to be less than 3%.

CONCLUSION

Radical proposals for change are bound to provoke fierce resistance from those who believe that they will be adversely affected. The dockyard proposals meet all the criteria for scepticism by collective interest groups. They will force changes that up to now have been avoided either by a withering of political will or by a well fought rear-guard action. Some of the resistance is ideological (opposition to privatisation), some of it a result of genuine concern for national security (dockyard employees are all of vetted status), and some of it a product of prospective loss of privilege. At base the real issue is whether the Royal Navy gets the best service its restricted budget can afford.

Of all the alternatives available, I believe the commercial management option is the one most likely to meet the Royal Navy's needs and the best interests of the employees of the dockyards, securing for them long-term job prospects, more interesting work and a more respectful use of their skills than the present regime which underuses their time.

At the time of Mallabar there were four UK naval dockyards. The procrastination and refusal to reform has seen two of them close down. If, another ten years on, the two remaining dockyards have not responded to the challenge of change, it may well be that the UK will end up without its dockyards, with consequential damage to its defence stance. Those currently concentrating on the negative aspects of change, and not its immense opportunities, might like to explain what future they see in the UK dockyards if commercial management is rejected, and some MPs might care to explain what their party's defence policies, in respect of the Polaris and Trident programmes, will do for dockyard employment within the next five years, with or without change.